

BILL # HB 2570

TITLE: tax credit; renewable energy

SPONSOR: Mason

STATUS: As Introduced

REQUESTED BY: House

PREPARED BY: Brian Cary

FISCAL ANALYSIS

Description

Beginning in tax year 2006, the bill provides an income tax credit to individuals and corporations of 1.5 cents per kilowatt hour (KWH) for energy produced and sold in Arizona from renewable energy resources. The credits are non-refundable and may be carried forward for five years. Qualified resources include biomass, geothermal energy, municipal solid waste, solar, wind, and small irrigation power. Conventional hydroelectric power is excluded.

Estimated Impact

JLBC Staff estimates the bill would reduce General Fund individual and corporate income tax revenue from \$(1.9) million to \$(3.0) million in FY 2006, \$(6.0) million to \$(9.5) million in FY 2007, and \$(9.2) million to \$(14.0) million in FY 2008. These amounts would continue to grow over time as renewable energy's share of total electricity sales increases and as total electricity sales also increase.

The lower end of the estimated range of the bill's cost is based on electricity to be sold by companies subject to ACC regulation and renewable energy standards. The upper end of the range assumes that Salt River Project's renewable energy sources would be supplied by independent producers that would be eligible to use the tax credits provided by the bill.

While HB 2570 would lead to a direct reduction in corporate and individual tax liabilities, it would create new investment in renewable energy resources and higher sales, employment and payrolls for businesses participating in the industry. The additional economic activity would lead to an offsetting increase in tax collections. This type of secondary, or dynamic impact, is difficult to estimate.

The Department of Revenue (DOR) did not provide an estimate of the bill's fiscal impact.

Analysis

Historically, very little renewable energy has been used to produce electricity in Arizona because it was more expensive than conventional fuels such as uranium, coal, natural gas and hydroelectric power. Since 2001, the Arizona Corporation Commission (ACC) has adopted an Environmental Portfolio Standard (EPS) that requires regulated utilities to increase the amount of renewable energy generated in the state. In order to meet these requirements, the electric distribution companies invested in renewable generation plants and developed programs to encourage customers to purchase or produce electricity from renewable resources.

In January 2005, the ACC Staff proposed new standards for the companies they regulate, with an increased emphasis on renewable resources other than solar energy, which is the most expensive to produce. The proposed guidelines would require regulated utilities to supply at least 1.25% of their annual retail electricity sales from renewable sources located in Arizona. This requirement would increase to 1.5% in 2007, 1.75% in 2008, and reach 5% in 2015. The utilities would be permitted to meet these requirements from the range of renewable energy sources that are included in the bill.

In addition to solar-powered energy systems, Arizona Public Service Co. (APS) and Unisource/Tucson Electric Power (TEP) have been actively developing renewable energy generation programs using biomass, municipal waste, and wind. Some of these plants are owned by the utilities, while others are or will be owned by other taxable entities. In order to meet the ACC's EPS requirements, they must be located in Arizona. It is assumed that all of the electricity generated by these facilities would be eligible for the tax credits provided by the bill.

Analysis (Cont'd)

The ACC Staff estimates that the utilities subject to the EPS requirements had retail electricity sales of approximately 36.3 billion KWH in 2003 and that sales would increase by 3% per year. If the regulated utilities were to meet the proposed EPS standards, the 1.5 cent per KWH tax credit would reduce General Fund revenue by \$(1.9) million in FY 2006, \$(6.0) million in FY 2007, and \$(9.2) million in FY 2008. These estimates assume that the use of the credits would phase in, with 50% used in the first year and 50% in the second year. We also assumed that half of the credit available would be claimed in the first fiscal year and the rest in the second fiscal year. Although tax liability is accrued on a calendar year basis, final tax payments and refunds are not issued until the following calendar year.

Salt River Project (SRP), which is not regulated by the ACC, has adopted its own set of Sustainable Portfolio Principles. SRP expects to meet these goals through a mix of demand-side management (DSM) programs and renewable energy resources. Over the next several years, SRP estimates that approximately 1.2% of their annual retail electricity sales will be supplied from renewable sources. However, they may elect to meet some of this demand from out-of-state sources of geothermal and wind-generated electricity.

Since SRP is not subject to state income taxes, any electricity produced from its own plants would not be eligible for the tax credit. To the extent SRP develops renewable energy generation plants within the state, it is not certain whether it would own those plants or whether they would be owned by other taxable entities that could avail themselves of the credit.

The tax credit's impact in SRP's service territory is uncertain. Any energy produced by out-of state resources or by SRP-owned facilities would not be eligible. SRP's retail electricity sales were approximately 24.3 billion KWH in its 2004 fiscal year. Assuming sales growth of 3% per year and that 1.2% of sales would be supplied from renewable, taxable sources, the SRP system would produce maximum income tax credits of \$(1.2) million in FY 2006, \$(3.5) million in FY 2007, and \$(4.8) million in FY 2008. The same phase-in assumptions described above were used to calculate these estimates.

The amount of credit claimed in any given year may be reduced by several factors. First, the utilities may not fully meet the scheduled goals. Second, the ACC's proposed EPS requirements may be modified before they are formally adopted. Third, some of the eligible companies, particularly small independent power producers, may not have sufficient tax liabilities to fully utilize the credits. Fourth, SRP's environmental programs may generate significantly less tax credit than the maximum amounts calculated above. Finally, there are existing federal tax credits (wind generated electricity is one example) that may be mutually exclusive with the state tax credit. Some taxpayers may elect to take the federal tax in lieu of the credit provided by the state.

Local Government Impact

Each year cities and towns receive an amount equal to 15% of income tax collections from two years prior. The reductions in corporate income tax collections would result in a reduction in local government distributions of \$(0.9) to \$(1.1) million in FY 2008, \$(1.4) million to \$(1.9) million in FY 2009, and \$(1.7) million to \$(2.4) million in FY 2010.

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